IV Four examples

1 Introduction

One important conclusion of the previous chapter was that abstraction is helpful rather than an obstacle in policy relevant scientific research. Without abstractive hypotheses there is no interesting theorizing and, hence, no policy relevant research beyond pre-scientific intuitions. Idealization, in contrast, is likely to cause trouble if it comes to intended interventions in the social world.

I shall consider four economic policy relevant economics cases, trying to detect whether they aim at vertical or horizontal isolation. In case of abstraction they are in need of the bite that makes abstract hypotheses interesting. In case of idealization they have to be de-idealised in order to apply to concrete situations.

First, I discuss Wicksell's attempts to develop a theory of capital building together with the interest theory he inherited from Böhm-Bawerk. Heinz Kurz has noted that Wicksell's ultimate aim was not to study the stationary state *stricto sensu* but to make use of a static view of the economy in order to ultimately highlight the dynamics of capital growth. However, the distinction between these two types of theoretical stance remains cloudy in his paper. The concepts of abstraction and idealization come in handy to explicate the distinction more clearly. The second case is a rather simple textbook example about the Keynesian macroeconomic explanation of involuntary unemployment. I shall use my explication of idealization and abstraction as a conceptual engine and note that an often repeated claim about Keynes' idealizational assumptions is false. The third case is a more complex treatment of theory and policy interventions in the inefficient Dutch market for health care before the latest restructuring of this market.[1] Finally, I shall look into the tacit idealizations in an argument against buying organic and fairtrade food. Their being tacit makes it look, superficially, like the use of a vague clause, about which I have commented that it might better be treated as abstraction. But a closer look reveals that some very well known facts are ignored such that a finite list of excluded variables figure in the background. The assumptions in the argument help idealise, not abstract a case.

[1] As of 2006 the Dutch have reinsured themselves against the costs of health care in a new system with more elements of a market economy.

2 Wicksell's stationary state

In a stationary state, capital is constant. This implies that the entrepreneurs exhaust all earned interest for consumption. They do not add saved interest to the principal sum: they do not accumulate. Wicksell follows Böhm-Bawerk in considering the way in which non-compound interest has to be calculated.

2.1 Building on Böhm-Bawerk: rent

In his *Positive Theorie des Kapitales*, Böhm-Bawerk assumed land 'away' for the ease of representation. He thought this would do little harm to the external validity of the model, because of the durability of this factor. It is a sort of perpetual.[2] The fruits of its use stretch out from the present to the far future, so the discounted value of these fruits are now negligible.

In section 6.2 of chapter I it has been explained that perpetuals only earn net yield as these are not depreciated: *Der Grund ist immer der gleiche wie früher*[3]. Suppose the yearly yield is indexed at 100. With a discount of 4%, the fruit of last year is worth 100/(1.04) = 96.15, of the year before it is now $100/(1.04)^2 = 92.46$, etcetera. The total value is the discounted value of all the yield calculated as the sum of an infinite geometric series. In the example it is of course $100 / 1.04 + 100 / 1.04^2 + \ldots + 100 / 1.04^{\infty} = 2500$ or the yearly yield is multiplied by 100 / 4.

Wicksell allowed the amount of labour allocated to one hectare of land to be endogenous. He could do so thanks to his mathematical treatment, which does not encounter the problem of a multitude of simultaneous equations – as long as the number of variables does not exceed that of equations. Böhm-Bawerk had been limited by his narrative approach. But he was grateful in the newer editions of PTK:

> Ich kann nur bedauern, daß mir, als Nicht-Mathematiker, die mathematischen Darlegungen *Wicksells* nicht völlig zugänglich sind; ich kann sie deshalb weder in ihrem Detail genauer verfolgen, noch mir für meine eigene Darstellung zu Nutze machen, und muß mich begnügen auszusprechen, daß sie nach ihrer mir erkennbaren Hauptrichtung eine jedenfalls in hohem Grade dankenswerte Ergänzung meiner Theorie zu bieten scheinen.[4]

With land as a separate factor, the subsistence fund is now needed to pay for wages and rent during the production process. (I continue the counting of the equations as started in chapter II, with the same choice of symbols.)

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[2] Perpetuals are bonds without closing date. This means that they will bear a fixed interest forever but are not paid back.

[3] PTK, p.423. He goes on (p.424): *Daß [der Grundstück] für den Eigentümer ein reiner Ertrag, ein reines Einkommen wird, das hat gar nichts mit Fruchtbarkeit, Lage, Bodenklasse usw. zu tun, sondern lediglich mit der geringeren Wertschatzung künftiger Güter… Die theoretische Erklärung der Grundrente fällt also in ihrem Schlussstücke mit der Erklärung ausdauernder Kapitalstücke zusammen.*

[4] PTK, p.426, note 1. Italics are in the original.

$$K = \tfrac{1}{2}tA(\ell+gr) = \tfrac{1}{2}t(A\ell+Br) \qquad (4)$$

Like in figure 1 of chapter I, production per worker per year is

$$p = (\ell+gr)(1+\tfrac{1}{2}zt) \qquad (5)$$

The optimum is given by:

$$dp/dt = (\ell+gr)\tfrac{1}{2}tz \qquad (6)$$

But, as B/A is endogenous, revenue per worker can also grow due to fewer workers per unit of land (or more land per worker)[5]:

$$dp/dg = r(1+\tfrac{1}{2}tz) \qquad (7)$$

2.2 Land as capital: the insertion of heterogeneity

Böhm-Bawerk had allowed to drop the assumption in the isolated model of homogeneous production functions in the last chapter of PTK. This not only involves that all marginal yields are the same (which has been listed as assumption (4) in chapter II), but it also opens up the possibility that end products (assumption (2)), labour (assumption (5)), but also land and capital goods are heterogeneous. It triggers the idea that there is a loop structure of capital (assumption (8)). However, Böhm-Bawerk had not been able to incorporate the consequences of all de-isolations into a coherent mathematical system, or General Theory. In Wicksell's model the allowance of heterogeneity of production caused to increase the number of equations and variables. Wicksell's trick was to work with the assumption of two countries with mutually different (due to different outputs) but internally homogenous production functions. Country 1 produces good x; country 2 produces good y.[6]

Endowments and production period must receive indices referring to countries i, j, marginal utilities will carry indices x and y. Under appropriate assumptions (related to market perfection), after opening trade these countries would appear as one single economic system with two types of production functions. Factor

[5] Wicksell remarks that in the theory of the marginal productivity of land, Von Thünen did thought experiments with several doses of capital, so as to calculate rent. Wicksell criticises him for not yet endogenising capital. This looks very much like Böhm-Bawerk's stepwise approach with several 'doses' of capital – or years of roundabout production. However, I believe the difference is that Böhm-Bawerk did want to endogenise t (it was his key to the mechanism) but lacked the mathematics.

[6] As we shall see below, Wicksell came to see how much more difficult this was by the time he published the original (Swedish) edition of the *Vorlesungen,* in 1901. Note the difference with the Ricardian trade model, in which each country produces the two commodities. Wicksell had a very different aim than Ricardo: the latter wanted to analyse the welfare effects of trade as compared to autarky, and for that the realistic assumption is required that domestic economies bring forth more than one product. The point of Wicksell is to trace how one economy with different production functions behaves. Hence his strategy is to merge two models of economies with homogenous production functions into one.

incomes thus loose their indices. In other words, one crucial new assumption is that of factor price equalisation, without which for each factor no single markets would exist in the two countries together[7]. Further assumptions remained:

- Output consists of non-durable consumer goods[8];
- The relation of capital to land is fixed;
- There are no futures and forward markets;

The set of equations, then, is:.

$$A = A_1 + A_2 \qquad (8)$$

$$B = B_1 + B_2 \qquad (9)$$

$$K = K_1 + K_2 \qquad (10)$$

$$g_1 = B_1/A_1 \qquad (11)$$

$$g_2 = B_2/A_2 \qquad (12)$$

Equations (4) to (7) above are doubled in number in the two-country two-commodities model:

$$K_1 = \tfrac{1}{2}tA_1(\ell+gr) = \tfrac{1}{2}t(A_1\ell+B_1r) \qquad (13)$$

$$K_2 = \tfrac{1}{2}tA_2(\ell+gr) = \tfrac{1}{2}t(A_2\ell+B_2r) \qquad (14)$$

$$p_1 = (\ell+g_1r)(1+\tfrac{1}{2}zt_1) \qquad (15)$$

$$p_2 = (\ell+g_2r)(1+\tfrac{1}{2}zt_2) \qquad (16)$$

So are the derivations:

$$dp_1/dt_1 = (\ell+g_1r)\tfrac{1}{2}t_1z \qquad (17)$$

$$dp_2/dt_2 = (\ell+g_2r)\tfrac{1}{2}t_2z \qquad (18)$$

$$dp_1/dg_1 = r(1+\tfrac{1}{2}t_1z) \qquad (19)$$

$$dp_2/dg_2 = r(1+\tfrac{1}{2}t_2z) \qquad (20)$$

We have until now thirteen equations, (8) to (20). The thirteen variables are A_1, A_2, B_1, B_2, K_1, K_2, t_1, t_2, g_1, g_2, ℓ, r, and z. The marginal utilities of x and y relate in

[7] See WKR, p.130. Note that, in the later Heckscher-Ohlin international trade models, this is not an axiom, but a theorem. Showing how axioms of models can be theorems of other models seems to be one important form of progress in economics.

[8] Durable capital goods are, so to say, home made. In fact, as the non-durable consumer goods are defined as the wages fund and, hence, as capital, Wicksell did at this stage not yet cope with the problem of the heterogeneity and the loop structure of capital. Once he tried to take this step, he ended up in the trouble of measuring the value of capital and the average period of production.

the same way as the prices of x and y, respectively. So Wicksell operated largely in a Walrasian way, assuming equilibria on all markets, without reference to the mechanism by which such equilibria come into being. This is the key difference between his and Austrian economic theory.

Nevertheless he said that the price relation of the commodities '*kann aber hier nicht als bekannt vorausgesetzt werden, es ist vielmehr eben unsere Aufgabe, zu zeigen, wie es durch das Spiel der sämtlichen volkswirtschaftlichen Kräfte bestimmt wird.*'[9] He goes on to say: '[*Wir müssen*] *uns auf den Markt des Tausches der beiden Waren versetzt denken, und die Bedingung dafür aufstellen, daß auch auf diesem Markte Gleichgewicht herrscht*'[10]. So there is a need for another equation, but the price relation of the goods is lacking. If π is the price of y in terms of a quantity of x, or x/y, then income e of an individual worker equals $x + \pi \cdot y$ or

$$e = x + (U'_y / U'_x) \cdot y \qquad (21)^{11}$$

So x and y can be expressed in terms of the factor rewards. Aggregate consumption of these commodities will be

$$\Sigma x = A_1 \cdot p_1 \qquad (22a), \text{ or}$$

$$\Sigma y = A_2 \cdot p_2 / \pi \qquad (22b)$$

so that

$$\Sigma e = A\ell + Br + Kz \qquad (23)$$

The system is now closed. If free trade takes place in a model under the assumption of two-countries and two-commodities, the two countries are similar to one country with markets for two final goods: there is one market for each factor of production. Hence, ℓ, r and z are not indexed for the type of industry. The exchange relation between the two goods is endogenously fixed when[12]: any of the factor incomes is maximised given the other two (partial analysis); factor incomes are equal in the two lines of production; available capital suffices to finance wages and rents (suggested by equations (13) and (14)); the goods are distributed such that their relative marginal utilities are equal to the exchange relations.

As this model represents a *stationary state* economy, the equilibrium situation is thought to persist. No new fixed capital[13] is added to the stock of durable production goods. Capital, labour, and land are taken as given and savings, other

[9] This phrasing does suggest a certain interest in mechanisms, but this is not what Wicksell is after when he merely paraphrases Böhm-Bawerk's system mathematically.

[10] WKR, p.133. This is like the Clarkian approach in the short run. See subsection 2.4 below.

[11] In equilibrium the goods are traded at a price relation that equals the inverse of the relation of their marginal utilities.

[12] WKR, p.135.

[13] Recall that the end goods that form the subsistence stock to finance labour and land are Böhm-Bawerk's floating –- or working –- capital. Tools, machinery, buildings and the like are called fixed capital, which nowadays stands in contrast with non-durable capital, such as combustibles.

than gross savings used for maintaining capital stock, are absent. There is as yet no short run or long run dynamics in the model. Another way of saying this seems to be by calling the method static.

Böhm-Bawerk's assumption had been that land can be treated as a special case of durable capital goods. However, the loop structure of investment and production[14] enters already at the level of land itself and not just at the level of capital. Böhm-Bawerk defined capital as piled up (or frozen) land and labour[15], but land, in turn, can be defined as a sort of capital good. This, then, implies that land partly consists of land, contradicting Böhm-Bawerk's other claim that land is an original factor. In other words, land cannot simply be calculated as the sum of an infinite geometric series in the way Böhm-Bawerk had done[16]. Wicksell conversely proposed to treat durable capital as a rent-earning good. He entered such goods as productive factors into the equations as 'B' and as 'g'. Due to Wicksell land got its autonomous status in the general theory.

The assumption of a stationary economy had allowed Böhm-Bawerk to calculate the average investment period as a measure of the quantity of capital: in PTK more capital is synonymous with longer roundaboutness. But with two original factors some capital may consist of more frozen land, other of more frozen labour. The heterogeneity of capital then props up more pressingly. If the project is to also make the model dynamic, tracking down the quantity of capital becomes a real problem. Kurz discusses the attempts by economists to repair Wicksell's model, which have turned into the debate on Wicksell's 'missing equation'. Kurz's analysis is interesting for two reasons. The first reason is that he misinterprets Wicksell on the period of investment and the failure to come to terms with the simple interest – as implicitly used by Böhm-Bawerk and explicitly in his own equations. The second reason why I am interested in Kurz's contribution is his treatment of the difference between the *idealization* of economies as being in a stationary state and the *abstractive* method of a static analysis.

One must distinguish between short run dynamics (or business cycle analysis) and long run dynamics (or growth trends). Capital changes in the longer term only. Hence, the most dramatic assumption dropped was a sort of domain assumption, that the models described the life of capital stock as being in stationary state. Many other assumptions subsequently had to be dropped with this one, the most important of which is the assumption that growing capital stock is heterogeneous. This means that the variable for the average period of production cannot be equal to ½t, so Wicksell substituted the symbol ε for ½ in WKR. But that would not solve the problem, for long term growing economies present us with the loop structure of capital. The investment period becomes intractable. This, then, is the nastiest problem Wicksell faced (and never really solved).

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[14] See note 76 of chapter I.

[15] Note that this definition applies both to durable capital goods with their key role in the capital theory and for the subsistence fund that was assumed in the interest theory.

[16] See chapter I, section 6.2, page 42.

2.3 Simple interest as a dispensable assumption

Some passages from Wicksell's work seem to imply strictly stationary conditions, numerous others cause 'this impression [to be] quickly dispelled'[17]. Heinz Kurz concludes that Wicksell did not want to describe stationary economies.

> There is additional evidence that Wicksell did not intend to study the problem of distribution in terms of a strictly stationary state of the economy. To see this we have to turn to his criticism of Walras and his successors.[18]

But does the quote really prove that Wicksell was not interested in the stationary state at all? Let us see what else Kurz and Wicksell claim about the conceptual struggle with the role of capital. Kurz indicates two ways for Wicksell to choose from: *either* capital is measured by some value unit, *or* capital – heterogeneous as it is – is represented by the average period of production in the economy (which is in fact Böhm-Bawerk's solution). This is in accordance with Blaug's analysis who quotes a paper by Wicksell claiming that either one can represent capital in the model as a cross section of existing capital (fixed and floating) goods or longitudinally, as 'having a time structure'.[19]

Kurz says that Wicksell started off using the average period of production as an indicator for the capital intensity of the economy. Allegedly, Wicksell wanted to explain the distribution of factor incomes in a static framework, even assuming fixed factor supply.[20] But to deal with growing capital stock, Kurz goes on, requires calculating compound, not simple interest. So Wicksell did not see the importance of the use of compound interest for the analysis he ultimately was after.

But this, I believe, is not true! Another quote can show this. Wicksell contended that assuming a stationary state makes the use of simple interest harmless, even 'essentially' so:

> Das Produkt εt, d.h. die Investierungszeit des Kapitals, kann aber hier als eine einzige Variable aufgefaßt werden, so daß *wenigstens bei Berechnung einfacher Zinsen* die Ausdrücke nicht wesentlich verändert werden.[21]

The words I put in italics clearly show that, *given simple interest*, and only under that condition, the quoted factor εt can be taken as exogenous. Wicksell does not

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[17] Kurz (2000), p.774.

[18] *Ibidem*, p.776.

[19] Blaug (1997), p.537. This paper is reprinted in the appendix of the *Vorlesungen I*. Blaug subsequently judges it unclear whether Wicksell's intentions embrace Walras' idea – expressed in his *Éléments d'économie politique pure* – that interest merely originates out of growing capital stock. This would however imply that capital in a stationary state has no time structure. Wicksell has been very clear about this from the start. Time and again, he endorsed Böhm-Bawerk's insight as groundbreaking that capital has a time structure even in the absence of growth, i.e. *in a stationary state*.

[20] Kurz (2000), p.775. Note, however, that the assumption of fixed factor supply is not required for either an analysis of a stationary state or for a static analysis of a dynamic model.

[21] WKR, p.101. Italics are mine. Wicksell referred here to the fact that the average production period (which boils down to the 'investment period') need not be $\frac{1}{2}t$, as the distribution of labour and land over the process of production can be subject to choice by the entrepreneur, or to technical conditions, giving rise to a period εt instead. The coefficient ε supposedly had to be empirically determined. It seems to me that the term *wesentlich* must be taken literally.

claim at all that the use of simple interest were of no matter for the essence of the analysis. Otherwise stated, he merely says that the conditional, with the assumption of simple interest in the antecedent, is true.

The whole idea was not to stick to the analysis of a stationary state, Kurz claims, but to a comparative static analysis. In that case the use of simple interest is not harmless at all, let alone *essentially* harmless. He says:[22]

> While he saw that compound interest was necessitated by the assumption of free competition, he seemed to think that using simple interest involved an admissible simplification and no 'essential alteration'. As we know, this presumption cannot be sustained.

But I believe that Wicksell knew that the use of simple interest was not harmless *in general*, i.e. in case one wants to study growing economies. In WKR, Wicksell shows that, taking into account compound interest, the end sum of capital (principal plus interest) will be equal to

$$s = \ell\int_0^t (1+z)^t dt$$

This is a revision of equation (1) in chapter II[23]. This equation allows us to calculate the same endogenous variables *in the stationary state analysis*. Both in WKR and in the major part of the *Vorlesungen I*, Wicksell explicitly assumes the stationary state. (It must be admitted that, if t and z both are large, the deviation between calculating simple compared to compound interest becomes very large too. This is the reason why Mark Blaug judges this a 'serious failing in Böhm-Bawerk's calculations'.[24] But the simplification is not so serious *in principle* and this is what Wicksell contended as he judged it as admissible.)

Kurz's claim, that Wicksell was not really interested in the stationary state, is untenable if it is taken to describe all phases of Wicksell's his career. He was interested in the properties of Böhm-Bawerk's idealised model with time as the essential factor, even if it described a stationary state. In the last chapter of the *Vorlesungen I*, on *Die Kapitalbildung*, the stationary state is finally abandoned. But that is precisely the passage which marks the next step in Wicksell's research.

Böhm-Bawerk, in his capital theory, had engaged in many considerations of positive and negative growth of the capital stock. This required a dynamic view. A static analysis of cross sections of a growing economy is of course conceivable but it does not allow for all questions of growth that one might want to take into consideration. Indeed, a static analysis highlights some aspects but covers up others. For example, a static description exposes no transition mechanisms that connect one state of the economy with a next state. It also curbs the discovery of the difference between a change in initial conditions and a change caused by agents' re-

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[22] Kurz (2000), p.781, referring to the (English translation of the) quote from the preceding note.

[23] WKR, p.98, note 1. See chapter II, p.73. If z is small and t is large, s will of course approximate $(1+z½t)\ell t$, as equation (1) indicates.

[24] See Blaug (1997), p.496. Blaug rhetorically suggests (though does not literally say) that Wicksell also judged it a serious failing.

sponses to unstable initial conditions. Perhaps even worse, a static analysis fails to show the difference between variations in initial conditions and in the very way in which agents tend to organize their responses to changing initial conditions, for example given the institutional environment. Many subtleties are suppressed because these remain, so to say, undiscovered.

2.4 Statics versus dynamics, stationary state versus long run growth

The stationary state: condition for static analysis or limiting case?

How do Böhm-Bawerk and Wicksell deal with statics and dynamics and with the stationary state and growth? We have seen that Kurz stresses both Wicksell's and Böhm-Bawerk's interest in growth rather than in the stationary state. I qualified Kurz's claim by noting that, concerning Böhm-Bawerk, the interest theory in PTK treats the stationary state up to the last chapter, only to turn to considerations of a growing economy in that chapter, and that the capital theory – largely disconnected from the distribution theory – tries to analyse long term growth of capital as well; and, concerning Wicksell, that his early WKR essentially analyses distribution in a stationary state, so as to merely clear the path for a study of capital growth in his later works. In addition, Wicksell praised Böhm-Bawerk (and criticised Walras) for his crucial insight that positive interest is possible even in a stationary state.

There is a potential confusion over the terms 'stationary' and 'static'. It is possible in principle to treat a stationary state dynamically, viz. to highlight short run market events in an economy at long run standstill. Also, it is viable to discuss growth by a static view if one is interested in the properties of a growing economy synchronically and not diachronically. Kurz's project (in his (2000)) is meant to show that much of the research on Wicksell's failure to develop a complete distribution theory for the case of modern economies is misguided due to its confusing the two concepts. This has induced the researchers to look for some missing equation in Wicksell's work, which is, he says, not missing at all. He draws on the clarification of (and the warning to observe) the distinction of the concepts already given by Lionel Robbins (1930):

> we must recognise not one general class of "static states" and "static laws", but two: the classical conception in which the condition of stationariness is the resultant of the balancing forces tending to change, and the Clarkian in which the factors of production are stationary by hypothesis, and equilibrium is attained within these conditions. Both rule out inventions and fundamental changes in nature and human beings. But the one admits the possibility of variations of labour and capital, the other excludes these by definition. […] The modern economist […] will recognise in the two constructions we have been examining, *not competing abstractions, but successive stages of exposition*.[25]

The differences are subtle. The Classical economists held a view of the economy as a system that produces long run equilibrium and, hence, of a stationary state until

[25] Robbins (1930), pp.206-7. Italics in the original.

interventions or spontaneous changes in initial conditions reset it; and they wondered about the conditions for such a stationary end state. John Bates Clark looked upon it as a system that produces long run equilibrium *only* under conditions of fixed endowments: he studied the economy under the given axiomatic condition of a stationary state. Thus, the picture seen by the Classical economists is a limiting case of Clark's approach. Kurz, then, notes that Wicksell did not assume a strictly stationary economy in the sense of the Classicals, but maintained a static point of view '*designed to throw some light on the actual, growing economy in terms of a comparative static analysis of consecutive states of the economy characterized, inter alia, by different "quantities of capital" in existence*'[26]. Wicksell did ultimately not aim for describing the limiting case.

It is important to note that it is not useful, perhaps not even intelligible, to speak of 'a static economy'. This is not just because economies are essentially dynamic systems, even if in a stationary state, but because it is only *the view of* such an economy – captured in a model – which can be static in kind. 'Static' refers to the property of a method, not to a property of a really existing or even hypothetical economic system.

Idealization of the stationary state

In the *Lectures on Political Economy*, Kurz says, Wicksell gave rise to later misunderstandings due to his ambiguous treatment of equilibrium. At one time Wicksell said that (1)

> 'augenblicklich begnügen wir uns jedoch mit dem, was man die *statische* Seite des wirtschaftlichen Gleichgewichtsproblems genannt hat, d.h. mit den Bedingungen der Erhaltung oder periodischen Erneuerung *stationärer wirtschaftlicher Verhältnisse*.'[27]

But at another time he referred to (2)

> nimmt man als einfachste, grundlegende Hypothese die *stationäre* Volkswirtschaft an, wo das Kapital und die übrigen volkswirtschaftlichen Faktoren annähernd je als eine unveränderliche Summe aufgefaßt werden können.[28]

The *first quotation* talks of the conditions for the possibility of a stationary state. The *second quotation* involves a stationary economy as the simplest hypothesis and as a mode of thought. In fact, however, Wicksell looked for a way to treat growing economies by a comparative static *method*, although he alluded to the 'stationary state' to refer to that method.

The stationary state analysis assumes stable endowments, reflected by fixed factor supply. But no such long run standstill economy was like what Böhm-Bawerk and Wicksell observed. In his WKR, Wicksell introduced the assumption of a stationary state as an isolative strategy. He studied a hypothetical economy.

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[26] Kurz (2000), p.777. I endorse this interpretation, but I repeat that I differ in opinion as concerns Wicksell's first phase, the early period in which he wrote WKR.

[27] Wicksell (1984 [1913]), p.163. Italics in the original. Kurz quotes the English version; see Wicksell (1951 [1901]), p.105.

[28] WKR, p.ix. Italics in the original. Kurz uses the English (1954) *Value, Capital, and Rent* (p.22).

This model economy in perpetual stationary state equilibrium, gave him an interesting research object. It allowed him to learn about the sources and level of interest and about the determinants of income distribution, without any form of capital growth. But it did not take him to his final goal. Kurz's main point shows that it is wrong to take Wicksell as trying to present a stationary state analysis '*stricto sensu'*. Indeed, for a theory of capital and distribution in the long run Wicksell dropped the assumption of a stationary state, changed his strategy, so to say, and started of with a static economic model of what actually is a long run dynamic situation. Let me now to express this in terms of the conceptual apparatus we have developed.

From de-idealization to abstraction

Wicksell dropped the clause of vertical supply curves so as to further approach what he thought was the kernel of actual economies. Part of the actual state of affairs is that capital and labour inputs rise with time. The false clause was relaxed; the external validity of the theory as developed after WKR had to increase. But the more sophisticated model was not strictly dynamic: it was an instance of comparative statics. Each step of the analysis was studied with a *'bereits angesammelten Kapitalvorrates'*.[29] Apparently, the result of every such step was an abstraction in the sense that Wicksell now disregarded the mechanics of the process.

I here present the de-idealizational reasoning step of dropping the clause about vertical supply curves and the abstractive step in the comparative statics as two distinct phases but in practice they really form one single step: their being one and the same thing *de facto* does not render the analytical distinction wrong.

Comparative static analysis is a repeated static analysis. The use of the instrument of successive synchronic views however does not imply the assumption of a world in long run arrest. Each synchronic slice of economic reality from its diachronic flux is an abstraction in the sense that the dynamics of the system is ignored. Nevertheless, the aim of it all is not to ignore but to study it. That is why the mode of analysis is repeated.

Recall that the proposed way to characterise 'abstraction' is by its ignoring details judged irrelevant for the issues at hand, just as when inferring existential generalizations. Wicksell ignored the dynamics but was nevertheless interested in (long run) economic development: comparative statics came in the place of real dynamics. Still, he did not introduce falsity by this mode of analysis. The process moving the world from one moment in the course of its development to another only remain unexplained. I can now qualify this mode of analysis as abstraction *ante explicationem*: a theory explaining the mechanics was not readily available but he awaited one. On the other hand, Böhm-Bawerk's mechanisms explained the stationary state, not a developing economy. Had he been able, at the time, to extend his mechanistic narratives, explaining an expanding economy, then perhaps Wicksell's efforts would have presented a case of abstraction *post explicationem*.

[29] Wicksell (1984, [1913]), p.219

3 Keynes and involuntary unemployment. The case of pure theory.

A neoclassical microeconomic orientation has it that without market rigidities, labour market adjustments come quickly enough to solve the problem of unemployment, *provided joblessness is not voluntary*. Involuntary unemployment is the phenomenon that jobless people would want but do lack a job at a competitive wage rate. In unison, neoclassic cannot see voluntary unemployment as an unemployment problem at all. Involuntary unemployment clearly cannot exist in a neoclassical world with perfect markets and complete contracts. This means that the existing wage rate is too low for an incentive to work more hours in a job. So the marginal utility of leisure exceeds that of earning a higher income. Unemployed are not *willing* to take a job or start a business of his own.

This, then, is the typical neoclassical explanation of *voluntary unemployment* and it explains why it is often assumed that Keynes, not the neoclassical theorists themselves, assumed labour market rigidities to develop a disequilibrium theory. Neoclassical economics is equilibrium economics. However we shall see shortly that, in the view of Keynes, permanent unemployment can only be explained in the neoclassical theory with reference to the existence of labour market rigidities. Many textbooks give a loose presentation of Keynesian economics, habitually claiming that the assumption of rigidities in the labour market is crucial to explain Keynesian disequilibria. I believe that this assumption is wrong-headed. According to the Keynesian concept, if unemployment is involuntary, it is *not* the consequence of a rigid suboptimal wage level.

Moreover, this is precisely the reason why neoclassical economists did not perceive the possibility of involuntary unemployment. Later theoretical developments explained the dynamics of incomplete and complete contracts.[30] A contract is incomplete if at least one of the stipulators aren't certain about the level of utility of his part of the deal. Thus, employers run the risk of a lower than expected quality of work done. A long lasting labour market relationship is efficient in the sense that the demander can trust the seller to deliver a desired level of quality in return for which the demander offers a rent on top of the payment. It is productive in the sense that under these circumstances more deals will be struck. The resulting wage level would be super-optimal for the worker in the model with incomplete contracts. It is this rent, which the unemployment foregoes. Hence, there is an interpretation of the concept of 'involuntary unemployment' as being unemployed and lacking the opportunity of displaying one's trustworthiness, and as missing the rent. Involuntary unemployment is then suboptimal for the supplier.

But unemployment can be involuntary in other, macro-economic contexts. Apart from frictional unemployment and voluntary unemployment, Keynes wrote: '*[t]he classical postulates do not admit of the possibility of the third category, which I shall*

[30] See for instance Brown, M., Falk, A., and Fehr, E. (2004).

define below as 'involuntary' unemployment' [31]. The postulates are paraphrased as:

> [T]he wage of an employed person is equal to the value which would be lost if employment were to be reduced by one unit […],; *subject, however, to the qualification that the equality may be disturbed,* in accordance with certain principles, if competition and markets are imperfect.
>
> [T]he real wage of an employed person is that which is just sufficient […] to induce the volume of labour actually employed to be forthcoming; *subject to the qualification that the equality for each individual unit of labour may be disturbed* by combination between employable units analogous to the imperfections of competition which qualify the first postulate.

3.1 The neoclassical model

Let us first briefly expand on the neoclassical economic model[32] to explain voluntary unemployment. Unemployment is defined as a labour supply surplus. See figures 1 and 2 for a schematic representation of the model.

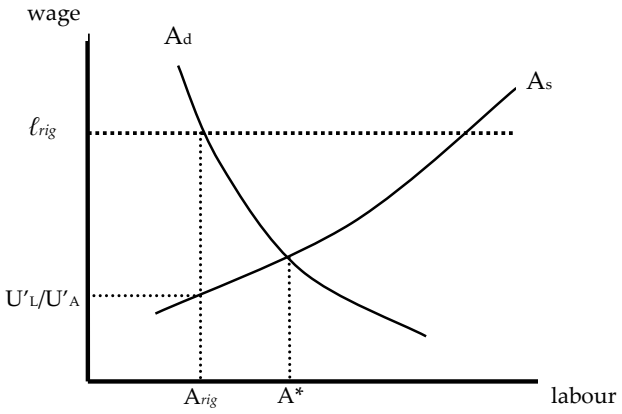

figure IV.1 The labour market with voluntary unemployment

In the figures, ℓ_{rig} is rigid wage level, the asterisk (*) indicates full employment levels, X is real output, A_d and A_s are demand and supply of labour, respectively. The starting point of neoclassical analysis is that the employers determine employment given a rigid wage level that is beyond their control. The idea is that

[31] Keynes, J. M. (1973), pp.5-6. Note that Keynes' report on these postulates already strongly suggests that the classical economists looked in market failures for disturbances of the laws they proposed.

[32] Unlike in the previous chapter, in this one I conform again to the economists' use of the term 'model' in the more loose way as something like 'formal representation'.

unemployment must be due to the problem that the employer's marginal labour cost (i.e. the extra wage paid) when an extra worker is set to be equal to the marginal pecuniary revenue. Keynes called this 'the first postulate of the classical theory' (respectively so listed above). Insofar as employees do not want to be unemployed (no involuntary unemployment), and in the face of being jobless, the relation of the marginal utility of leisure time, L, and of extra income – U'_L/U'_A – will be set equal to wage ℓ again. In other words, workers will decide to give up leisure time, even at lower wage levels. This is what Keynes called 'the second postulate of the neoclassical theory'.

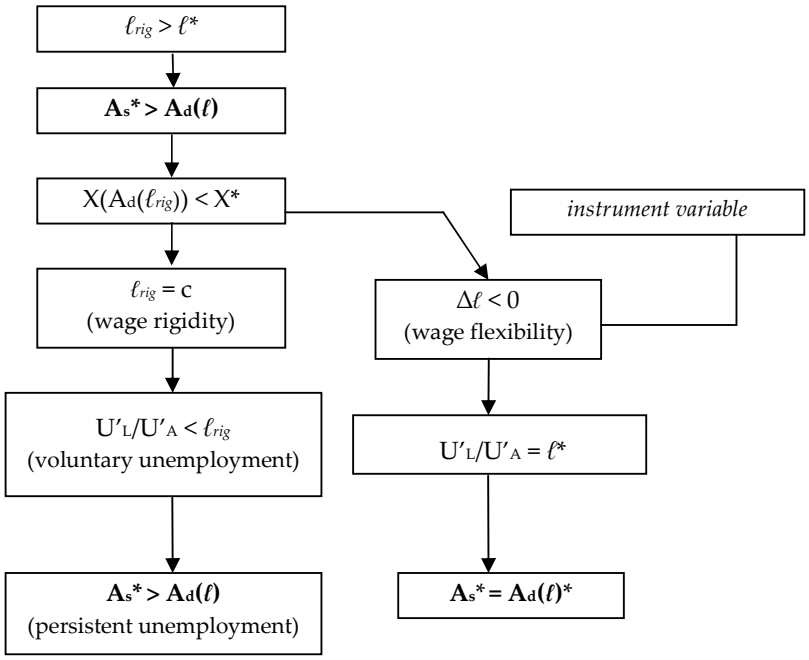

figure IV.2 (Lack of) labour market adjustment, classical analysis

If workers do not wish to give up more leisure, a labour supply surplus persists due to voluntary unemployment. (In the case of monopolistic market power of 'closed shop' trade unions, individual workers may be unemployed involuntarily, but as members of the union they are seen as voluntarily unemployed.) The wage level is instrument variable.

Wage level ℓ is to fall to the point where marginal revenue of labour equals marginal disutility or pain of loosing an extra hour of leisure. So in this model, persistent unemployment indeed is due to market imperfections. For example, wage rigidity can manifest itself in the form of trade union power that creates

some form of oligopoly in the labour market. The solution to this problem, from the point of view of policy makers, is to be found where the point of application of policy tools lies: in making the market more flexible.

3.2 The Keynesian model

In Keynes' view, the problem of unemployment is as in figure 3.

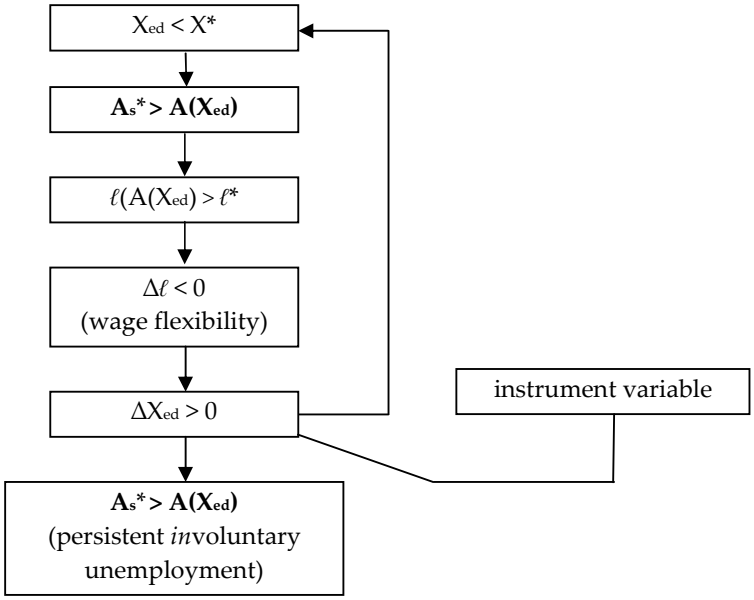

figure IV.3 Involuntary unemployment, Keynesian analysis

This view is, in a sense, diametrically opposed to this analysis and so is the policy recommendation that one could derive from Keynesian economics. It is important to repeat that Keynes ascribed explanations in terms of market imperfections and wage rigidities to the neoclassical economists. Hence, it is unlikely that Keynesianism can be associated, ever so often, with reference to wage rigidity. The key mistake of neoclassical economic thought was, as Keynes believed, that it gave domestic income a role exogenous to the microeconomic model and determined by given factor endowments, like A_s. It ignored the macroeconomic feedback of wage changes onto aggregate effective demand, X_{ed}, and, hence, on domestic income.

The starting point of the Keynesian analysis lies at the highest level of aggregation. Aggregate effective demand for commodities, X_{ed}, lags behind aggregated supply, X^*. The typical economists' meaning attached to this phenomenon is 'sub-optimal usage of domestic productive capacity'; in Wicksell's terms it would

be failing 'product exhaustion'. The most flexible factor is labour as capital and land are fixed for some time. Labour functions as a buffer. Also in this model leisure L has low utility, which is consistent with involuntary unemployment (there is a low disutility of working). It must be added that this is false, strictly spoken, for Keynes objected to the second postulate of the classical theory on several grounds, one of which was expressed by the argument of a *reductio ad absurdum*[33]. More fundamentally, Keynes did not believe that real wages are directly determined by the wage bargain. But in order to ease the exposition of the contrast between the neoclassical analysis and the Keynesian analysis of unemployment I shall assume – as Keynes sometimes did – that the second postulate holds good, only to investigate what this would amount to. The argument is that it amounts to even more unemployment.

With a cheaper wage bargain, entrepreneurs are not (or not sufficiently) induced to raise their demand for (now cheaper) labour, as sales tend to drop even further: the downward pressure on money wages causes a further erosion of aggregate effective demand. The output gap depresses nominal prices, which in turn determine real wages. Demand is an instrument variable. Keynes opened his *The General Theory* thus:

> Most treatises on the theory of value and production are primarily concerned with the distribution of a given volume of employed resources[34].
> […] whilst Ricardo expressly disclaimed any attempt to deal with the amount of the national dividend as a whole, Prof. Pigou, in a book which is specifically directed to the problem of the national dividend, maintains that the same theory holds good when there is some involuntary unemployment as in the case of full employment.[35]

The very point Keynes made is that it doesn't. It must be read as a proposal to endogenise aggregate income.

3.3 Idealization and abstraction in the analyses

I repeat that the classical economists had to explain disturbances by reference to market failures. The very assumption that markets, ideally, are without failures buttresses the various general equilibrium theories. Such theories have a normative bearing because they point to the relevant instrument variable: 'if you want to solve the *economic* problem of unemployment, take away market failures'.

We can now say that the *General Theory* explained the possibility of a labour supply surplus. In contrast, neoclassical explanation is about the same explanan-

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[33] *Ibidem*, p.13. The argument is that it would be absurd to conclude that labour supply decreases in case real wages fall as caused by rising prices. If the formula were true, a rise in the cost of living would cause workers to withdraw their labour offer. In fact, the argument disputes the realisticness of the assumptions.

[34] Keynes (1973), p.1.

[35] *Ibidem*, p.5, note 1.

dum, but by reference to strict assumptions. A condition in the clause (i.e. flexible prices) was not fulfilled. This is also how they could stick to their concept of voluntary unemployment. An unemployed person is someone who refuses to work for a competitive real wage or who organises his bargaining power in the form of an monopoly, i.e. by trade union representation. Such behaviour results in surpluses. Assuming that this is not the case renders an *idealization*. The list of possible market failures is provided by the theory and it is a finite list. For instance, the ceteris absentibus clause takes care of it. Keynes's theory helps deduce the theorem of involuntary unemployment, which serves as explanans of labour market disequilibria. This theory in turn *abstracts* from labour market failures.

A misunderstanding looms that I should prevent from occurring here. I did certainly not mean to maintain that abstraction be somehow related to *endogenising* the factors, which a theory abstracts from and that idealization be associated with keeping variables *exogenous* to the economic model. Not at all. Although Keynes endogenised aggregate income in order to have a theory which – he supposed – could explain persistent and demand-induced unemployment, endogenising itself is not the issue in abstraction. He developed a theory about a type of (non-frictional) unemployment, which does not evolve out of any labour market rigidities. This enabled him to ignore the question of whether such rigidities were actually present in various sections of the labour market. *The General Theory* does not deny that there also may exist unemployment induced by inflexible markets. Market failures had already been studied by contemporary economists in Cambridge, such as Joan Robinson. But for the explanation of the type of unemployment that Keynes studied it is simply irrelevant whether other types than demand induced involuntary unemployment actually occurred as well.

Let me summarize the roles of explanans and explanandum, seen from the viewpoint of Keynesian explanations of unemployment, in the scheme below.

Economic phenomenon	**In Keynes**	**In neoclassical theory**
Aggregate income	*Explained (endogenised)*	*Abstraction ante explicationem*
Labour market imperfections	*Abstraction post explicationem*	*Idealization*

To explain unemployment Keynesian theory endogenised aggregate income. It was a key concept in his macroeconomic theory. The neoclassical economists, in turn, abstracted from aggregate income: this is abstraction *ante explicationem*, because there was not yet a theory which could take care of the endogeneity of aggregate income. However, the opening pages of the *General Theory* acclaim that income is not to be ignored. Keynes, in turn abstracted, from something else: mar-

ket imperfections. He could do so without selling their actuality short. He could also admit that imperfections do cause forms of unemployment (that we now call 'structural'). But these particular forms of unemployment had already been studied in other research contexts. This is why I classify these as subject to abstraction *post explicationem*. But, quite apart from this, labour market imperfections did not play any role in Keynesian explananda or explanantia. It was irrelevant for Keynes.

4 The Dutch market for health, care, and cure.

The third case is about the ubiquitous problem of inefficiency in health care. In the Netherlands, several political and administrative committees have chosen an economic perspective in the formulation of policy proposals for solutions. The common denominator of the successive recommendations was the plea for more market incentives in health care.[36] The hopes were that, in this way, surpluses and shortages together with the rise in costs would disappear. The dominant idea behind this is that the more a market looks like the ideal of a *free*, *complete* and *perfect* market, the more efficient this market will be.[37] Particularly important is the desire to decrease the grip of the administration on the market. The ideal of a free market is centre stage in a liberal policy orientation.

A market is supposed to be efficient if it generates Pareto-optimality. The operative assumption in advising to allow for market incentives is not that *ideal* markets are efficient – they are by definition – but that any *real* market is efficient to the extent that it looks like the ideal. Let me put this with some more precision.

Often, in some markets at least, disequilibria vary directly as non-market conform government intervention intensifies. One can think of the markets for housing or agricultural produce. Furthermore, incomplete markets tend to create monopolies. Fewer bakers in an area goes with higher prices for bread, and not just in theory. I think we may conclude that the ideal type of freedom, completeness, and perfection is a fair compass reading for the orientation of microeconomic policy. Still, more market conform incentives have produced nothing of the expected results in the Netherlands so far.[38] This has been caused by the use of some quite different assumptions than merely those of freedom, completeness and perfection

[36] Mostly, the idea was to combine market elements with solidarity. Advisers recommended a role for competition between medical staff and between health insurance companies and for freedom of choice for the insured. See Ministerie van WVC (1988) and (1990).

[37] Not all textbooks use these terms in the same way. I take 'free' to mean freedom from government interference, 'complete' is any market on which no one can affect prices individually, and 'perfection' is absence of friction.

[38] At the time of writing this, the organisation of Dutch health care is in a major transition towards a system with a greater role for market incentives, the effects of which cannot yet be clearly seen (at least not by me). Some of the descriptions in this section may have lost their relevance to the situation of today.

in the sense I have used these in discussing Austrian economic thought. The point with the market for health care is not that it suffers from imperfections (although it does) but that there are also some other properties that do not necessarily amount to imperfections. They are to be qualified as 'idiosyncrasies', rather than as imperfections. Therefore, they remain rather implicit in general economics textbooks. Economists explain the problem with regard to this specific market explicitly with reference to these particularities.

4.1 Idiosyncrasies of the health care market

I shall list three idiosyncrasies of health care systems that help explain their fate. For my aim, I shall abstract from some properties, like the institutional fact that governments use health care as a means to redistribute disposable income. The heavy government intervention in this sector is a consequence of the obligations article 22 of the Dutch constitution imposes on the administrative authorities. The institutional environment causes the market of health to deviate strongly from a 'normal' market, let alone from some ideal of a market. So I do not go into every aspect of the complex institutional environment.

Let me discuss the following three special features of the market. The *first* distinctiveness has to do with one aspect of the institutional arrangement. The *second* concerns the specific perspective demanders engage in when they experience utility. The *third* involves suppliers behaviour.

As to the *first*, a necessary condition for optimization is that the patient, the decider, and the payer are joined in one and the same individual. But in health care these roles are distributed over three different economic subjects exactly so. This is easy to see. The patient uses medicine, the physician prescribes it, and the insurance company pays for it. This is of course caused by the inevitable role of insurance companies. Compare this with a normal market. If you buy your pint of lager, if it is *you* who has decided to do so, *you* pay for it and *you* are drinking it as well. This property, of what I should like to call 'the split in roles', can be judged a real imperfection. Health care is not the only market with such a property. Dutch parents pay for the schoolbooks their children will use, whereas the choice of these books are decided upon by the teachers.[39] Then again, we can see the publishing houses making supernormal profits. Of course, some other institutional elements add to this sub-optimal outcome. In the Netherlands, for instance, all books have been subject to legal resale price maintenance for a long time after WW2.

The *second* particularity is the strong tendency towards demand-inducing supply: once it is there, people want it. This is a form of preference drift seen in any market, but it takes a prominent shape in health care. Viagra presents us with a telling example. This is often not understood as a means to relieve a medical problem, but as an aphrodisiac. Other examples of medical treatment abound. The

[39] See also Rol (1998).

point here is not that marketing techniques in general try to raise a certain preference drift. But demanders of care have a very special view of the meaning of therapies and health. A related aspect is that satisfaction given by health care products is a derived utility. Patients do not feel to purchase a cure of a disease, but indeed health. There seems to be no presumption that they themselves must take care of their health. If the user were also the one who pays, this awareness would arise quickly. But now it does not and demand behaviour goes off the rails.

The *final* distinctiveness concerns satisficing supply behaviour. Such behaviour has been observed and measured in the behaviour of New York taxi drivers.[40] Medical doctors in the Netherlands have always been paid by the number of treatments they do. Though they are entrepreneurs within the hospital, they do not seem to maximize their incomes. In debates on the causes of the emergence of waiting lists, some economists have mentioned satisficing as one of them. Also this is not exclusively a property of the health care market.

4.2 Health care and 'the social model'

So what does all this mean for this market? Perhaps health care is simply no example of anything like a market. But this objection is inconsistent with the proposal to introduce 'more market' in the industry. To exaggerate it perhaps, 'more market' is to serve a policy maker's desire to make a market distribute health care as efficiently as wide screen television sets. Thus, a policy orientation towards economic liberty praises withdrawal of government intervention (other than that of antitrust legislation) in the market. However, as explained, at least three properties of the trade in care and health have been identified by economists as impeding a quick settlement of problems of government intervention. First, it presupposes that demanders and users decide on the basis of the same considerations as the financier does. Second, utility of health care would derive from what the product actually does, not from what it is unreasonably trusted it does. Third, medical staff would be eager to maximize both income and effort to treat as many patients as possible. The question I now want to answer is this. Where in the scheme of epistemic operations – of abstraction and idealization as explicated above – do we have to situate the complex of assumptions under review?

I have claimed in chapter III that (1) this phenomenon could be explicitly defused by a clause. Further, I have said that (2) some phenomenon, which is seen as potentially disturbing, could also simply be ignored. The first method is called 'idealization'. The second strategy has been marked 'abstraction'.

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[40] See Camarer et al (1997). One may of course wonder whether this is a case of satisficing in Simon's sense (see Simon (1957)). It can as well be conceived as a particular form of their (the taxi drivers' and medical doctors') utility curves. Whatever the ways in which we can classify this behaviour, the effect is the treatment of fewer patients than what seems to be optimal from the point of view of the demand side of the market. This is a rather old concern – see for instance Anderson (1979) – but still in debate – see for instance Marelich et. al. (1998).

In what follows, I shall consider the phenomenon that effective demand for care appears to have no limit and assume, for the sake of argument, that this is exclusively caused by the split in roles of patient, physician, and financier. Most prominently, the one who pays for the treatment lacks the means to curb demand. Ignoring it is simple. But an idealizational clause would say that, given an integration of the three roles in one person, the market would benefit from decreased government interventions. Now, if theory has to generate proposals for policy, this clause has to be coped with somehow.

If the phenomenon in question in fact makes part of a domain of desired policies, abstract theory (let me denote it again AA) will only serve as a useful source of policy recommendations if there is (or will soon be) a complementary theory (X), which teaches us something about the roles of patient, physician, and insurance company. So assume that theory AA tells us nothing about this aspect of the real market. As government policies are embedded in a complex environment, such a complementary theory will not rarely originate in other disciplines, like sociology, business administration, the study of law, and psychology.[41] The table below summarises the options. I shall consider them in the respective order.

WAYS TO DEAL WITH A CLOSURE REGARDING A POLICY RELEVANT PHENOMENON			
	Explanans	**Explanandum**	**Epistemic operation**
1	an idealising clause to a theory DD	The phenomenon is a disturbance	idealization
2	absent: theory AA does not refer to the phenomenon	The phenomenon is out of sight	abstraction
3	Hypothesis X	The phenomenon is an instantiation	explanation

A theory AA, which is essentially about ideal type markets, does not explain the cited phenomenon.[42] One can think of a theory *idealising* from these effects, that is, to introduce an idealizational clause (CL) into the idealised perfect markets theory (denoted DD in chapter III). The clause explains how the disturbing phenomenon, call it a demand surplus, occurs despite the theory's predictions. In other

[41] The morale of an article by the Dutch economist Folmer (2000), in a journal on economics and policy, is that social sub-disciplines have to be integrated much more than actually is the case. (The revealing title of it is 'Why economists blunder so often'.) Folmer calls the desired integrated complex of theories 'the social model'. I must say that I am not sure whether such an *integration* of sub-disciplines is too much to ask. There is a certain disinterest for, or even derision of, other social sciences in mainstream economics. It seems to me that mere scientific *cooperation* would do much of the job.

[42] The term 'ideal type' bears reminiscence to Max Weber, and it is to be loosely understood in this way. Hence, it should not be associated with idealization.

words, CL is explanans of the phenomenon and the perfect markets theory merely refers to – is true of – (a particular subset of) the set of models of CL. This need not be problematic for the idealised theory as such. But for policy relevance, this practice boils down to treating these characteristic effects as disturbances. One can entertain the belief that CL – counterfactually saying that the roles of patient, physician, and financier are integrated in one and the same person – does not hold back policy relevance. The belief that it does not entails the assumption that the idealised state of affairs under description sufficiently approximates aspects of the real world that form the domain of policy. If this confidence is however not justified, the idealization must be understood as delivering externally invalid policy recommendations.

In case of *abstractive* operations, on the other hand, the economist assumes that there is or can be an other explanans than the specified clause. This other explanans deals with the problem of the split in roles. The theories underlying this other explanatory hypothesis may have been developed before, or we can expect these theories to be available at some future date. In the fist case we have abstraction *post explicationem*, in the latter we have abstraction *ante explicationem*. A theory (labelled AA in the table) that abstracts from the market peculiarity in question is obviously oriented at other aspects of the market than this very peculiarity. Once the problem of the split in roles turns out to be relevant for policy, one has to draw from an other (complementary) theory that does take this idiosyncrasy of the health care market as its explanandum. The table refers to such an alternative complementary theory in terms of '*hypothesis X*'.

5 The economics of environmental governance

In 2006, under the cynical slogan 'Buy organic, destroy the rainforest', the weekly magazine *The Economist* contended that the production and consumption of organic food is bad for the environment.[43]. Generally, the argument to buy organic refers to conventional intensive farming, which uses chemical inputs. 'But', the editors say, 'it all depends what you define as "environmentally friendly" '. Ever since humans farm, deforestation has been the result. Although chemicals are bad, an extensive way of farming which satisfies global nutrition needs would require several times the currently cultivated land. More rainforest would have to be given up. Chemical fertilizer has contributed to multiplying agricultural yields with very little increase of land under cultivation. Hence 'If you think you can make the planet better by clever shopping, think again. You might make it worse'.

Something similar as with organic food is argued as regards fairtrade food. Farmers in Third World countries suffer from the exposure to volatile world mar-

[43] 'Good food?' (2006)

ket prices. Their income marginalises as prices drop. Fairtrade food is sold at a higher than market price, subsidising the farmers. 'But', it is claimed, 'prices of agricultural commodities are low because of overproduction.' Indeed, low prices are supposed to be signals of supply surpluses and the appropriate reaction to this should be a cut in production. The fairtrade subsidy deprives the price of its function as a messenger of scarcity relations. What poor farmers should do is not producing more of the same but diversify. To bolster the price is to depress it further, as output rises in the face of surplus. Fairtrade food creates its own strain. (In addition, but not of importance of the argument in this section, 'the system gives rich consumers an inflated impression of their largesse'.)[44]

5.1 The adverse effects of ethical food in your trolley

Clearly, the issues, so provocatively presented in this article, are relevant for public or private policy. In the light of the categorisation I presented in chapter III, the question arises whether the inevitable assumptions underlying the economic argumentation against 'Good Food' generate isolations of the horizontal or of the vertical tailoring, or of both. This is an important question. As I argued, abstractive isolations need not render policy irrelevance. Abstraction often helps focus on crucial relationships of factors that may otherwise remain out of sight due to the wealth of detail of the issue under study. But then again, abstraction may also result in propositions too weak to have a bite. The trick, so to say, is to abstract interesting economic relations between variables without losing grip on the handles for intervention. On the other hand, idealizational isolations result in propositions true only of hypothetical worlds. For any kind of involvement of policy, the idealizational clause must be dropped if reality does not approximate the nomological machinery of the economic theory containing the clause.

The Economist recommends to abstain from ethical shopping. This will admittedly not be sufficient to create a finer world; ending protective agricultural policy comes into the bargain too. In 2007, out of the European Union budget €55 billion will be spent on the Common Agricultural Policy (CAP). In real terms the CAP budget has increased from € 330 billion over the last seven-year budget to €371 billion over 2007-13. The costs of CAP will also account for a bigger *share* of the new EU budget than it currently does (from 42.6% in 2005 to 43% on average over the 2007-13 total).[45] After a gradual decline of this share over the eighties of the previous century, it is on the rise again. The French government has already made it clear that they will still veto any cuts in the CAP. All this tax payers money (approximately 0.4% of the total Gross National Product of 27 European countries) results in artificial pricing, making it impossible for Third World farmers to compete. Meanwhile, agricultural prices are set too high, so that Europeans, after con-

[44] Another category the article treats is local food, produced closely to the consumer.
[45] Open Europe bulletin (2005).

tributing to an unfair system as taxpayers, pay too much for their food in their role as consumers.

I shall not go into the obvious need for abolishing unfair trade. The article concerns private action ('voting with your trolley'). Given that the ends are worth to be pursued, are the recommendations to consumers – to be liberal rather than ethical – a good idea? There are three tacit assumptions at stake. Two deal with organic food, one with fairtrade food.

The first assumption is that chemical fertilizer has less of a detrimental effect on the ecosystem than deforestation. But there is no argument sustaining this proposition. The absence of such an argument is in line with the assumptions being tacit. Only if deforestation is worse does intensive farming have the biological advantage over extensive farming. Whether this is the case depends on the ways in which extensive farming is put through. Chemical fertilizers have long run effects that we only are beginning to understand, inclusive of soil exhaustion. A comparison with the harm done by deforestation is much needed.

The second assumption is connected to the first. There is not just the choice between using chemical fertilizers and manure. One must also select between monoculture and crop biodiversity on a pasture. Recent experiments in Wageningen, the Netherlands, suggest that growing several types of crops on one piece of land keeps out diseases and increases yields. The assumption, then, is that agriculture is one-dimensional. You either farm and destroy the forest, or you don't and keep the forest intact. In this reasoning, there is no room for speculations about simultaneous farming and foresting.

The third assumption plays a role in the argument against fairtrade. Low prices reflect decreasing scarcity, so subsidies finance overproduction. It is implicitly assumed that these prices are competitive-market prices. However, the criticism against protective agricultural policy by the big trading blocks is that they cause artificial pricing, so it is hard to see how the price level, which harms the farmers, must be interpreted as a signal. But I am interested in a further assumption. The article talks of overproduction while famine is ubiquitous. Apparently, effective demand is taken to be the same as 'need'. It is a remarkable plea that production should be cut while people are hungry. The point is not overproduction but access to markets. Moreover, the argument does not take into account the external effects of farming, such as jobs, infrastructure, and an economic environment that drums up a little hope to the poor. Some of these external effects can be studied with economic theories, but especially the latter, hope, is a psychological category economists have typically little to say about.

5.2 Idealizational assumptions and their policy implication

The assumptions seem to *abstract* from the details that I mentioned in the above discussion. They focus on particular properties of a market mechanism, which seemingly are taken to be essential for understanding what ethical shopping brings about. No assertions seem to be expressed about the positive externalities of farming, or about known long run effects of chemical fertilizers, so also no false assertions. A theoretical hypothesis about the alleged mechanism by which ethical shopping causes harm rather than fortune is an explanans, the harm itself the explanandum (the description of it thought to be true). A defender of organic and fairtrade food would then have to propose a competing theoretical analysis.

I believe, however, that the editors *idealise* over the subject matter that I discuss here. Idealization, I proposed, is an isolation by which one uses a clause with a finite set of false propositions. Much – though not as much as we should like – is known about the effects of the prolonged use of chemicals. We can also be sure that biodiversity on the pasture helps protect crops in better ways than pesticides do. The list of phenomena about which one does better not to speak untruthfully is already there. Assuming that the ecological harm of chemicals is less of a problem than deforestation is risky, because we lack a decent yardstick. Assuming that any farming necessarily damages the forest is plainly false. De-idealization may well induce the theorist to favour ethical shopping.

But then again it may not. It is possible, at least in principle, that the advice of the article is right. After de-idealization, for example, one may conclude that, given everything we know, the amount of harm done with extensive farming is still more severe than using chemicals. But under the force of the idealizational clause we shall never know this. We must assume true claims about the other circumstances, and only then theorise about them. Idealization summons irrelevance.